

HAIG POINT UTILITY, INC.

DOCKET NO. 2005-34-W/S

BEFORE THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION

Testimony Prepared: June 13, 2005

Hearing Date: July 18, 2005

PRE-FILED TESTIMONY OF JOHN F. GUASTELLA

THIS TESTIMONY IS FILED PURSUANT TO THE ORDER OF THE PUBLIC SERVICE COMMISSION DATED APRIL 11, 2005. IN ACCORDANCE WITH THE PUBLIC SERVICE COMMISSION'S RULES OF PRACTICE AND PROCEDURE AND THE AGREEMENT OF THE APPLICANT, THE COMMISSION, THE OFFICE OF REGULATORY STAFF, AND THE INTERVENOR, THE APPLICANT RESERVES THE RIGHT TO PROVIDE REBUTTAL TESTIMONY TO THE TESTIMONY PRE-FILED PURSUANT TO SAID ORDER BY THE COMMISSION STAFF, ORS, AND INTERVENORS AND TO ANY TESTIMONY PROVIDED AT OR BEFORE THE JULY 18, 2005 HEARING AND THE JULY 14, 2005 PUBLIC "NIGHT" HEARING.

1 **BY MR. WALKER: Please state your name.**

2

3 BY MR. GUASTELLA: John F. Guastella.

4

5 **BY MR. WALKER: Please state your business address.**

6

7 BY MR. GUASTELLA: Guastella Associates, Inc., 6 Beacon Street, Suite 325, Boston,
8 Massachusetts 02108.

9

10 **BY MR. WALKER: Please state your occupation.**

11

12 BY MR. GUASTELLA: I am President of Guastella Associates, Inc.

13

14 **BY MR. WALKER: Please describe Guastella Associates, Inc.**

15

16 BY MR. GUASTELLA: Guastella Associates, Inc. provides utility management, valuation
17 and rate consulting services to both regulated and unregulated utilities.

18

19 **BY MR. WALKER: Please describe your educational background.**

20

21 BY MR. GUASTELLA: I graduated from Stevens Institute of Technology in June of 1962,
22 receiving a degree in Mechanical Engineering.

23

1 **BY MR. WALKER: Have you completed additional training and/or education**
2 **since your graduation in 1962?**

3
4 BY MR. GUASTELLA: I have completed courses in utility regulation sponsored by the
5 National Association of Regulatory Utility Commissioners ("NARUC") and conducted by
6 the University of South Florida, Florida Atlantic University, the University of Utah, Florida
7 State University, the University of Florida and Michigan State University.

8
9 **BY MR. WALKER: Do you hold any professional licensure?**

10
11 BY MR. GUASTELLA: I am a licensed professional engineer.

12
13 **BY MR. WALKER: Please state your work history.**

14
15 BY MR. GUASTELLA: From 1962 to 1978, a total of sixteen years, I was employed by the
16 New York State Public Service Commission. With the exception of two years in which I
17 was involved in the regulation of electric and gas utilities, my time with the Commission
18 was devoted to the regulation of water utilities. After a series of promotions during the
19 years 1962 to 1970, attained through competitive examinations, I was promoted to Chief of
20 Rates and Finance in the Commission's Water Division. In 1972 I was made Assistant
21 Director of the Water Division. In 1974 I was appointed by the Chairman of the
22 Commission as Director of the Water Division, a position I held until my resignation from
23 the Commission in August of 1978.

1 **BY MR. WALKER: What were your duties in your various positions at the New**
2 **York State Public Service Commission?**

3
4 BY MR. GUASTELLA: My duties with the Commission included the performance and
5 supervision of various engineering and economic studies concerning valuation of utility
6 property, financing, rates and service of electric, gas and water utilities. While in the Water
7 Division, I either examined or supervised the examination of the books and records of
8 literally hundreds of water utilities. As Director of the Water Division, I was responsible for
9 the regulation of more than four hundred and fifty water companies in New York, heading a
10 professional staff consisting of thirty-two engineers and three technicians. One of my
11 primary duties was to advise the Commission during its adjudication of formal proceedings,
12 as well as other matters. In the course of those deliberations I reviewed and analyzed
13 testimony, exhibits and briefs submitted in formal proceedings. My duties and
14 responsibilities covered such subjects as the reasonableness of investments in utility plant,
15 acquisitions, depreciation, contributions in aid of construction, advances in aid of
16 construction, construction work in progress, working capital, amortization's, rate base,
17 revenue level, operation and maintenance expenses, taxes, cost of capital, fundable capital,
18 financing, capital structure, rate of return, rate design, rate structure, quality of service and,
19 in general, all aspects of utility valuation, rate setting and service. Another major
20 responsibility was the review of all proposed legislation affecting water utilities in New
21 York and the subsequent preparation of recommendations for use by the governor or the
22 legislature in considering such legislation. I also made legislative proposals and participated
23 directly in drafting bills that were enacted. One example of legislation I was involved in

1 expanded the New York Public Service Commission's jurisdiction with respect to the
2 regulation of the service provided by small water companies. Another dealt specifically
3 with rate regulation and financing of developer-related water systems. During my
4 employment with the Commission, I handled or supervised the handling of thousands of
5 consumer complaints by individuals, corporations and municipal, governmental and
6 political officials.

7
8 **BY MR. WALKER: What did you do when you left the New York Public Service**
9 **Commission in 1978?**

10
11 BY MR. GUASTELLA: In 1978, I formed Guastella Associates, Inc. Additionally, from
12 1987 to 1991, concurrent with my position as President of Guastella Associates, Inc., I
13 served as President of Country Knolls Water Works, Inc., where I directed the management
14 and operation of a utility which served approximately five thousand customers.

15
16 **BY MR. WALKER: Please state your particular expertise in the regulation of**
17 **utilities and other utility matters.**

18
19 BY MR. GUASTELLA: In addition to the experience I have already discussed, I have
20 prepared appraisals and valuations of utility property, depreciation studies, rate analyses,
21 cost allocation and rate design studies, and management and financial analyses. I have
22 provided consulting services for municipal and investor-owned water and sewer utilities, as
23 well as gas utilities and solid waste collection and disposal companies.

1 **BY MR. WALKER: Before what regulatory agencies and municipal jurisdictions**
2 **have you previously presented expert testimony?**

3
4 BY MR. GUASTELLA: I have presented expert testimony in the states of Alaska,
5 California, Connecticut, Delaware, Florida, Georgia, Illinois, Indiana, Maryland,
6 Massachusetts, Missouri, Montana, Nevada, New Jersey, New Mexico, New York, North
7 Dakota, Texas, Ohio, Pennsylvania, Rhode Island, South Carolina and Virginia.

8
9 **BY MR. WALKER: Are you active in professional organizations and associations?**

10
11 BY MR. GUASTELLA: Yes. I have been or am active in the National Association of
12 Regulatory Utility Commissioners , the National Associations of Water Companies, and the
13 American Water Works Association

14
15 **BY MR. WALKER: Please describe your participation in the National Association of**
16 **Regulatory Utility Commissioners.**

17
18 BY MR. GUASTELLA: I served as Vice-Chairman of the Staff-Committee on Water of
19 the National Association of Regulatory Utility Commissioners ("NARUC"). While on that
20 committee, I prepared an instruction manual entitled, "Model Record-Keeping Manual for
21 Small Water Companies," which was published by NARUC. The manual describes in detail
22 the kinds of operating and accounting records that should be kept by small water utilities,

1 with instructions on how to use those records in order to properly operate a water system
2 and properly keep account of the cost of providing service.

3
4 Additionally, since 1974 I have prepared rate case study material, assisted in the
5 coordination of the program and served as an instructor at the Annual Fall Seminar on Water
6 Rate Regulation sponsored by NARUC and conducted by the University of South Florida,
7 Florida Atlantic University, University of Utah, the University of Florida, Florida State
8 University, and Michigan State University. This seminar is recognized as being one of the
9 best in the country for teaching rate-setting principles and methodology. It is attended by
10 representatives of regulatory agencies, utilities, and engineering, accounting, economic and
11 law firms throughout the country.

12
13 In 1980, as a special consultant to NARUC, I assisted in the establishment of another similar
14 seminar that has been held annually in the spring in the western United States.

15
16 **BY MR. WALKER: Please describe your participation in the National Association of**
17 **Water Companies.**

18
19 BY MR. GUASTELLA: As a member of the National Association of Water Companies
20 ("NAWC"), I served on its Rates and Revenue Committee and Small Company Committee.
21 I have also served on a joint committee on rate design composed of staff members of
22 NARUC and NAWC.

1 **BY MR. WALKER: Please describe your participation in the American Water Works**
2 **Association.**

3
4 BY MR. GUASTELLA: I have served on the Water Rates Committee of the American
5 Water Works Association ("AWWA") and assisted in the preparation of the AWWA Rates
6 Manual, Third Edition. In connection with my serving on the referenced committees and in
7 connection with various client projects I have undertaken in the course of my work, I have
8 participated in decisional meetings to determine proper engineering and construction criteria
9 in relation to costs in the design of water and sewer systems.

10
11 **BY MR. WALKER: Please describe any teaching or seminars you have conducted.**

12
13 BY MR. GUASTELLA: In addition to the NARUC seminars already mentioned, I have
14 prepared and presented papers at a number of meetings of NAWC, NARUC, the New
15 England Conference of Public Utilities Commissioners, the Mid-America Regulatory
16 Conference, the Public Utility Law Section of the New Jersey Bar Association, the
17 Pennsylvania Environmental Council, the Southeastern Association of Regulatory Utility
18 Commissioners, the New Jersey Chapter of AWWA, and the Florida, New England, New
19 Jersey and New York Chapters of NAWC.

20
21 In 1979, I served as an instructor and panelist in a seminar on water and sewer utility
22 regulation conducted by the Independent Water and Sewer Companies of Texas.

1 In 1998, I prepared and conducted a rate regulation seminar in Maine on behalf of the New
2 England Chapter of the National Association of Water Companies (NAWC).

3
4 In 2000 and 2001, in conjunction with Florida State University, I established and conducted
5 a special seminar for developer-related and small water and sewer utilities. This seminar
6 provided instruction as to the financial structuring, valuing, financing, rate setting and
7 regulatory requirements for small investor-owned utilities. In 2003 I conducted a similar
8 seminar in conjunction with the University of Florida.

9
10 **BY MR. WALKER: Can you estimate how many individuals you have taught rate**
11 **setting for water utilities in your professional life?**

12
13 BY MR. GUASTELLA: In all, I estimate that I have taught rate setting to more than 4,000
14 students, mostly regulators, in the last 29 years.

15
16 **BY MR. WALKER: What is the nature of your involvement in this proceeding?**

17
18 BY MR. GUASTELLA: Guastella Associates, Inc. has been employed by Haig Point
19 Utility Company, Inc. ("HPU") in connection with the filing of a rate increase. More
20 specifically, we were asked to analyze HPU's cost of operations, to prepare the necessary
21 schedules and testimony in support of a rate increase and to participate, as necessary, in
22 the rate case.

1 **BY MR. WALKER: What was the scope of the work performed by your firm?**

2
3 BY MR. GUASTELLA: Gary C. White, Director of Accounting for Guastella
4 Associates, Inc., and I analyzed HPU's financial records and operating data. Mr. White
5 performed much of the financial analyses reflected in the Schedules and Work Papers
6 submitted in support of this rate application. This allowed us to determine HPU's revenue
7 requirement based on operating data for the twelve months ended June 30, 2004 and as
8 projected for the pro forma fully developed system inclusive of known and measurable
9 changes. We worked with HPU's management to compile data for the preparation of the
10 rate analysis. This rate study has already been marked as Applicant's Exhibit Number 4.

11
12 **BY MR. WALKER: Did you meet with or receive data from individuals**
13 **representing HPU in connection with your assignment?**

14
15 BY MR. GUASTELLA: Yes. Throughout the process of preparing the rate study, which
16 supports HPU's application for a rate increase, Mr. White and I have worked closely
17 with HPU's management to understand HPU's financial position and future growth.

18
19 **BY MR. WALKER: Who did you meet with or receive data from in connection**
20 **with your assignment?**

21
22 BY MR. GUASTELLA: I spoke with Thomas Connor, who provided financial data on
23 behalf of HPU. It is my understanding that Mr. White also interacted with Mr. Connor

1 and, through Mr. Connor, with Jim Collins, an engineer with Thomas & Hutton's
2 Savannah, Georgia office, and with Sabina Finnegan, an engineer associated with HPU.

3
4 **BY MR. WALKER: What documents or data did you or your company receive**
5 **from Mr. Connor?**

6
7 BY MR. GUASTELLA: Mr. Connor provided financial data on behalf of HPU,
8 including HPU's balance sheet and income statements, as well as data related to HPU's
9 financial position, historical operating costs, and projected future operating costs. Mr.
10 Connor also provided information compiled by Mr. Connor regarding the construction
11 projects undertaken related to HPU and by Ms. Finnegan regarding the water
12 consumption rates for HPU customers.

13
14 **BY MR. WALKER: Did you or someone on behalf of your company request these**
15 **documents or data from Mr. Connor?**

16
17 BY MR. GUASTELLA: Yes, as the information provided was vital to performing the
18 analysis.

19
20 **BY MR. WALKER: Were the documents and data you or your company received**
21 **from Mr. Connor of a type reasonably relied upon by experts within your field of**
22 **expertise to form opinions or complete a rate study?**

1 BY MR. GUASTELLA: Yes.

2

3 **BY MR. WALKER: What documents or data did you or your company receive**
4 **from Mr. Collins and Ms. Finnegan?**

5

6 BY MR. GUASTELLA: Mr. Collins provided data various projects within Haig Point
7 Plantation. For each project, Mr. Collins provided the approximate scope of water
8 distribution, the approximate scope of sewage collection, the date of operating permit
9 issuance, the value of the project, the value determination method, and various comments
10 regarding each project. Ms. Finnegan provided historical data on HPU's customers'
11 water consumption.

12

13 **BY MR. WALKER: Did you or someone from your company request these**
14 **documents or data from Mr. Collins and/or Ms. Finnegan?**

15

16 BY MR. GUASTELLA: Yes. We requested the data from Mr. Connor, who, in turn,
17 requested it from Mr. Collins and Ms. Finnegan.

18

19 **BY MR. WALKER: Were the documents and data you received from Mr. Collins**
20 **and Ms. Finnegan of a type reasonably relied upon by experts within your field of**
21 **expertise to form opinions or complete a rate study?**

22

23 BY MR. GUASTELLA: Yes.

1 **BY MR. WALKER: Will address different areas of the rate study in your testimony**
2 **than Mr. White did in his?**

3
4 BY MR. GUASTELLA: My testimony addresses the overall methodology and rate
5 setting approach, and Gary White's testimony addresses the detailed revenue requirement
6 schedules.

7
8 **BY MR. WALKER: Would you please describe the rate increase which HPU has**
9 **requested?**

10
11 BY MR. GUASTELLA: HPU has filed for a rate increase to provide a 63.5% increase in
12 metered water revenue and a 222.4% increase in sewer revenue on the basis of a
13 projected complete system analysis. The proposed water rate design eliminates the
14 minimum usage allowance of 22,500 gallons per quarter, maintains the base service
15 charge at the existing rates, and establishes an inclining block rate for irrigation
16 customers. These changes in rate design are made to promote water conservation. The
17 sewer rate design also eliminates the minimum usage allowance. The sewer rates were
18 developed maintaining the existing ratio of base revenue to usage revenue. HPU is not
19 proposing changes to its tapping fees, backflow prevention charge or system development
20 charge in this rate filing.

21
22 **BY MR. WALKER: What are the financial bases and test year used to support**
23 **these increases?**

1 BY MR. GUASTELLA: The rate increases are based on an analysis of the books and
2 records for the actual twelve month ended June 30, 2004 operating results and the
3 projected cost of service for fully developed water and sewer systems.
4

5 **BY MR. WALKER: Why did you develop rates reflecting a fully developed system**
6 **or, in other words, using a "complete system" methodology?**
7

8 BY MR. GUASTELLA: HPU anticipates considerable growth in Haig Point Plantation
9 before completion. For 2004, HPU had an average of some 207 customers, but the Haig
10 Point Plantation Development is planned for 778 customers. In order to assure that the
11 customers actually served during the 2004 rate year and during the growth years would
12 only pay their proportionate share of the operating and capital costs of utility systems
13 capable of serving a larger customer base, we projected the level of rates that would be
14 necessary to cover the cost at system completion, at today's dollars. This calculation was
15 not adjusted for inflation. Using the complete system analysis or methodology, the rates
16 for service will be lower than would otherwise be necessary during the growth period, as
17 HPU moves forward to system build-out.
18

19 **BY MR. WALKER: How do the two projections, the 2004 test period versus the**
20 **completed system, compare?**
21

22 BY MR. GUASTELLA: Under the proposed rates, the projected operating results for the
23 fully developed system would produce an overall rate of return of 9.25%. For the 2004

1 test period, however, the rate of return would be only 1.71% for water and 4.38% for
2 sewer. The differences indicate that during 2004 the proposed rates would have covered
3 operating expenses and a return on a portion of investment, but there is a portion of the
4 investment for which the stockholders will bear the carrying costs. Under the complete
5 system analysis, the current customer base will only bear their proportionate share of the
6 entire cost of operations. This approach mitigates the impact of the rate increase on the
7 existing customers, and precludes them from bearing any risk of the success or failure of
8 the real estate project.

9
10 **BY MR. WALKER: Would you please briefly describe the rate setting principles as**
11 **reflected in the schedules filed in support of the rate increase?**

12
13 BY MR. GUASTELLA: Yes. I would note that Gary White's testimony describes the
14 schedules in support of the rate increase as to the calculation of adjustments and
15 projections, and sources of information. My testimony focuses on certain issues which
16 have not been addressed directly by Mr. White. All of these Schedules are contained
17 within Applicant's Exhibit Number 4.

18
19 Schedules A-1 and A-2 provide the balance sheets and income statements, respectively.
20 The income statements show that HPU has not achieved an adequate rate of return, and
21 will not do so absent a rate increase.

1 Schedule B-1 sets forth the calculation of rate base for the historical period ended June
2 30, 2004, and projections for the water and sewer complete systems, with adjustments
3 made for known and measurable changes.

4
5 Schedule B-2 sets forth the calculation of utility plant in service for the same periods. The
6 projections include the capital improvements for the well additions and water storage
7 tank, currently under construction, necessary to serve additional customers.

8
9 Schedule B-3 sets forth the accumulated depreciation through June 30, 2004 and adjusted
10 for the depreciation through system completion. The depreciation calculation utilizes
11 depreciation rates impacted for the percentage of system utilization, allowing for the
12 recovery of depreciation costs at the rate of customer growth.

13
14 Schedule B-4 contains the Contributions In Aid of Construction ("CIAC") as of June 30,
15 2004 and projected through system completion. The projected CIAC includes additional
16 contributions by applying the existing level of tapping fees to the number of additional
17 customer connections. The increases are based on HPU's growth projections and
18 existing tariff charges. The rate base is adjusted for the amortization of CIAC.

19
20 **BY MR. WALKER: Would you please describe the remaining rate base**
21 **components?**

22
23 BY MR. GUASTELLA: Yes. The average unamortized debit represents the estimated
24 balance of rate case expenses. The estimated cost of the current rate case is being

1 amortized over four years. The working capital component represents an allowance for
2 funds expended for operating and maintenance expenses prior to receiving revenues for
3 the service provided. The rate setting theory is similar for each item, providing a
4 mechanism to recover the carrying cost of unrecovered funds or utility investments.

5
6 **BY MR. WALKER: Would you please summarize the (C) schedules contained in**
7 **Applicant's Exhibit 4?**

8
9 BY MR. GUASTELLA: Schedule C-1 contains the income statements for the twelve
10 months ended June 30, 2004 under existing and proposed rates. The revenue figures
11 for the operations under a projected complete system reflect the revenue requirement
12 which is necessary to cover operating expenses and a reasonable return on investment.

13
14 On Schedule C-1(W), for the water system, the "Complete System, Pro Forma, Proposed
15 Rates" column reflects our estimate of the operating expenses, depreciation and taxes,
16 and the resultant net operating income in the amount of \$100,259.00. It also shows the
17 projected rate base in the amount of \$1,083,852 and a 9.25% rate of return. The proposed
18 water rates are designed to generate \$455,746.00 of revenues, assuming a full
19 complement of system customers. As can be seen on Schedule C-1 (W), the rate of
20 return for the pro forma complete system is a negative 2.67% under present rates.

21
22 Similar information for the sewer system is presented on Schedule C-1(S) which shows
23 pro forma complete system net operating income of \$137,919.00, a projected rate base of

1 \$1,490,912.00 and a 9.25% rate of return. The proposed sewer rates are designed to
2 generate \$535,940.00 of revenue, assuming a full complement of system customers.
3 As can be seen on Schedule C-1(S), the rate of return for the pro forma complete system
4 is a negative 7.52% under present rates.

5
6 **BY MR. WALKER: Is there a need to expand the explanation of adjustments on**
7 **Schedules C-2(W) and C-2(S)?**

8
9 BY MR. GUASTELLA: No. In addition to the explanations provided on those
10 schedules, Mr. White's testimony provides further comments.

11
12 **BY MR. WALKER: Please describe how you developed the proposed capital**
13 **structure.**

14
15 BY MR. GUASTELLA: The water and sewer capital structures shown on Schedule D-1
16 reflect the projected capital structures synchronized to the projected rate base for the
17 complete system. The Debt/Equity ratio of 50%-50% is based on the hypothetical debt
18 and equity balance at system completion. The cost rates are 7.5% for debt capital and
19 11.0% for equity capital, producing a weighted cost or overall rate of return of 9.25%.

20
21 **BY MR. WALKER: What is the basis for the debt cost rate and return on equity?**

22
23 BY MR. GUASTELLA: The debt cost rate is based on judgment and our recent
24 experience with other utility companies and their ability to acquire long-term debt with

1 interest rates in the range of 7.5%. The equity return used is also based on judgment.
2 HPU is a privately held company. Its shares of common stock are not publicly traded and
3 therefore it is not possible to obtain a calculation reflecting market trade conditions that
4 would produce a representative rate of return on equity---one that truly enables HPU to
5 attract equity capital. It has been my experience that smaller utilities are considerably
6 riskier than the larger utilities which have stronger financial positions. Given its size and
7 relatively higher risk profile, it is appropriate to provide an equity return of 11.0%. The
8 operating result using this level of equity return is also in line with the range of operating
9 margins shown on Schedule A-4.

10
11 **BY MR. WALKER: Would you describe Schedule E-1, E-1.1, E-2 and E-3,**
12 **contained within Applicant's Exhibit Number 4?**

13
14 BY MR. GUASTELLA: These schedules set forth the billing analyses under existing
15 and proposed rates for water and sewer customers. The E-1 and E-1.1 schedules detail
16 the 2004 test year billing information and E-2 and E-3 provide the projected billing
17 information.

18
19 **BY MR. WALKER: Based upon the rate study performed by Guastella Associates,**
20 **what are the rates proposed?**

21
22 [BY MR. GUASTELLA: The proposed rates are shown in Work Paper 13.

23 *[Contained within Applicant's Exhibit 4]*

1 **BY MR. WALKER: In your opinion, are the proposed rates reasonable?**

2

3 BY MR. GUASTELLA: Yes. The proposed rates are absolutely necessary in order to
4 provide a reasonable rate of return on investment in plant and facilities used and useful in
5 providing service, and to cover HPU's operating expenses. The rates are based on sound
6 rate setting principles and methodology, and the proposed rates produce revenue levels
7 that are fair, reasonable and compensatory.

8

9 **BY MR. WALKER: On what do you base your opinion that the proposed rates are**
10 **reasonable?**

11

12 BY MR. GUASTELLA: I based my opinion upon a review of the financial analyses
13 contained in the Schedules and Work Papers submitted in support of the rate application
14 and upon my professional experience.

15

16 **BY MR. WALKER: Does that complete your direct testimony?**

17

18 BY MR. GUASTELLA: Yes.